

## **806 KAR 7:090. Custodial accounts for investment securities of insurance companies.**

RELATES TO: KRS 304.7-360

STATUTORY AUTHORITY: KRS 304.2-110, 304.7-360

NECESSITY, FUNCTION, AND CONFORMITY: KRS 304.7-360 requires the Executive Director of Insurance to promulgate administrative regulations governing the deposit by insurers of securities with clearing corporations, the Federal Reserve book-entry system, or custodian banks.

Section 1. Definitions. Terms defined in KRS 304.7-360 shall have the same meaning when used herein.

Section 2. Standards for Custodial Agreements. Pursuant to KRS 304.7-360, an insurance company may provide by agreement for the custody of its securities with a custodian bank meeting the qualifications set forth in Section 3 of this administrative regulation which securities may be held by the custodian bank, its nominee, in a clearing corporation, or in the Federal Reserve book-entry system. Such securities, whether held by the custodian bank, its nominee, in a clearing corporation, in the Federal Reserve book-entry system, or in any combination of these entities, are referred to herein as "custodied securities." Any such agreement shall contain provisions to comply with the following standards:

(1) The agreement shall be in writing and shall be authorized by a resolution of the Board of Directors of the insurance company or of an authorized committee thereof.

(2) Certificated securities held by the custodian bank may be so held separate from the securities of the custodian bank and of all its other customers or in a fungible bulk of securities as part of a Filing of Securities by Issue (FOSBI) arrangement.

(3) Securities so held in a fungible bulk by the custodian bank and securities in a clearing corporation or the Federal Reserve book-entry system shall be separately identified on the custodian bank's official records as being owned by the insurance company. Said records shall identify which custodied securities are held by the custodian bank or by its nominee and which securities are in a clearing corporation or the Federal Reserve book-entry system. If the securities are in a clearing corporation or the Federal Reserve book-entry system, said records shall also identify where the securities are and, if in a clearing corporation, the name of the clearing corporation or, if held in nominee name, the name of the nominee.

(4) All custodied securities that are registered shall be registered in the name of the insurance company, in the name of a nominee of the insurance company, in the name of the custodian bank or its nominee, or, if in a clearing corporation, in the name of the clearing corporation or its nominee.

(5) Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company.

(6) The custodian bank shall arrange for execution of transactions in custodied securities in accordance with the insurance company's instructions and shall not exercise discretionary authority to effect transactions in custodied securities except in such limited or special circumstances as the insurance company may authorize.

(7) The custodian bank shall be required to send or cause to be sent to the insurance company a confirmation of all transfers of custodied securities to or from the account of the insurance company. In addition, the custodian bank shall be required to furnish the insurance company with reports of holdings of custodied securities at such times and containing such information as may be reasonably requested by the insurance company, but not less frequently than monthly.

(8) During the course of the custodian bank's regular business hours, any officer or employee of the insurance company, any independent accountant selected by the insurance company, or any representative of the executive director shall be entitled to examine, on the premises of the custodi-

an bank, the custodian bank's records relating to custodied securities and the custodied securities, but only upon furnishing the custodian bank with written instructions to that effect from an appropriate officer of the insurance company or the executive director.

(9) The custodian bank and its nominee shall be required to send to the insurance company:

(a) All reports which they receive from a clearing corporation or the Federal Reserve book-entry system on their respective systems of internal accounting control; and

(b) Reports prepared by outside auditors with respect to the respective systems of internal accounting control of the custodian bank and its nominee pertaining to custodial record keeping as the insurance company may reasonably request from time to time.

(10) The custodian bank shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's annual statement and supporting schedules as filed with various regulatory authorities and in connection with any audit of the financial statements of the insurance company.

(11) The custodian bank shall provide upon request appropriate affidavits substantially in the form attached hereto (Appendix A) with respect to custodied securities.

(12) The custodian bank shall be obligated to indemnify the insurance company for any loss of custodied securities, except that the custodian bank shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian bank.

(13) In the event that there is a loss of custodied securities for which the custodian bank shall be obligated to indemnify the insurance company as provided in subsection (12) of this section, the custodian bank shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from said loss of securities.

(14) The agreement may provide that the custodian bank will not be liable for any failure to take any action required to be taken under the agreement in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing war), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.

(15) In the event that entry in a clearing corporation or in the Federal Reserve book-entry system is gained through a direct participant or a member bank, there shall be an agreement between the custodian and the direct participant or member bank under which the direct participant or member bank shall be subject to the same liability for loss of custodied securities as the custodian bank; provided, however, that, if the direct participant or member bank shall be subject to regulation under the laws of a jurisdiction which is different from the jurisdiction the laws of which regulate the custodian bank, the executive director may accept a standard of liability applicable to the direct participant or member bank which is different from the standard of liability applicable to the custodian bank.

(16) The agreement must be terminable by the insurance company on not more than thirty (30) days' notice.

**Section 3. Qualifications of Custodian Banks.** Any custodian bank selected by an insurance company to act as custodian under an agreement authorized by KRS 304.7-360 shall possess the following qualifications:

(1) Its custodial functions for the insurance company shall be carried out under its trust department;

(2) It shall be audited annually by independent public accountants whose audit report, together with the related financial statements, and whose report on internal controls are made available to the insurance company and the executive director;

(3) It must be organized under the laws recognizing that the custodied securities are "special deposits" rather than "general deposits," remain the specific property of the insurance company, and

are not subject to any creditor relationship of the custodian bank.

(4) It must maintain blanket bond coverage relating to its custodial functions with limits equal to or exceeding those suggested by the American Bankers Association.

(5) Its capital and surplus funds shall equal or exceed \$25,000,000 unless it is licensed and regulated by the Commonwealth of Kentucky, in which case its capital and surplus funds shall equal or exceed \$10,000,000; and

(6) It must have demonstrated sufficient experience in handling custodial accounts.

Section 4. Effective Date. This administrative regulation shall become effective upon its approval pursuant to KRS Chapter 13A. (9 Ky.R. 89; Am. 375; eff. 10-6-82; TAm eff. 8-9-2007.)

## APPENDIX A CUSTODIAN AFFIDAVIT

STATE OF \_\_\_\_\_ )  
\_\_\_\_\_) SS:  
COUNTY OF \_\_\_\_\_)

\_\_\_\_\_, being duly sworn deposes and says that he is \_\_\_\_\_ of \_\_\_\_\_, a banking corporation organized under and pursuant to the laws of the \_\_\_\_\_ with its principal place of business at \_\_\_\_\_ (hereinafter called the "Bank"):

That his duties involve supervision of activities of the Bank as custodian and records relating thereto;

That the Bank is custodian for certain securities of \_\_\_\_\_, having its principal place of business at \_\_\_\_\_ (hereinafter called the "insurance company") pursuant to an agreement between the Bank and the insurance company;

A. With respect to any securities entrusted to Bank's care and not redeposited elsewhere:

1. That the schedule attached hereto is a true and complete statement of securities (other than those caused to be deposited with The Depository Trust Company or like entity or a Federal Reserve Bank under the Federal Reserve book-entry procedure) which were in the custody of the Bank for the account of the insurance company as of the close of business on \_\_\_\_\_; that, unless otherwise indicated on the schedule, the next maturing and all subsequent coupons were then either attached to coupon bonds or in the process of collection; and that, unless otherwise shown on the schedule, all such securities were in bearer form or in registered form in the name of the insurance company or its nominee or of the Bank or its nominee, or were in the process of being registered in such form; and

2. That the Bank as custodian has the responsibility for the safekeeping of such securities as that responsibility is specifically set forth in the agreement between the Bank as custodian and the insurance company; and

B. With respect to any securities entrusted to Bank's care and redeposited with a clearing corporation:

1. That the Bank has caused certain of such securities to be deposited with \_\_\_\_\_, and that the schedule attached hereto is a true and complete statement of the securities of the insurance company of which the Bank was custodian as of the close of business on \_\_\_\_\_, and which were so deposited on such date; and

2. That the Bank as custodian has the responsibility for the safekeeping of such securities both in the possession of the Bank or deposited with \_\_\_\_\_, as is specifically set forth in the agreement between the Bank as custodian and the insurance company; and

C. With respect to any securities entrusted to Bank's care and evidenced by a book entry at a

Federal Reserve Bank:

1. That it has caused certain securities to be credited to its book-entry account with the Federal Reserve Bank of \_\_\_\_\_ under the Federal Reserve book-entry procedure; and that the schedule attached hereto is a true and complete statement of the securities of the insurance company of which the Bank was custodian as of the close of business on \_\_\_\_\_ which were in a "General" book-entry account maintained in the name of the Bank on the books and records of the Federal Reserve Bank of \_\_\_\_\_ at such date; and

2. That the Bank has the responsibility for the safekeeping of such securities both in the possession of the Bank or in said "General" book-entry account as is specifically set forth in the agreement between the Bank as custodian and the insurance company; and

That, to the best of his knowledge and belief, unless otherwise shown on the schedules, said securities were the property of said insurance company and were free of all liens, claims or encumbrances whatsoever.

Subscribed and sworn to before me this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_\_.

\_\_\_\_\_(L.S.)  
Vice President or other  
authorized officer